92-1751

No. _____

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

October Term, 1992

ALCAN ALUMINUM CORPORATION,
Petitioner,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEAL OF THE STATE OF CALIFORNIA IN AND FOR THE SECOND APPELLATE DISTRICT

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the use of a three-factor formula generally referred to as worldwide combined reporting, which assigns a portion of the worldwide income of a group of companies headed by a non-United States domiciled foreign parent by comparing sales, payroll and property values in California with sales, payroll and property values around the world, violates the Commerce Clause of the United States Constitution, Article I, Section 8, Clause 3.

RULE 29.1 STATEMENT

Petitioner, Alcan Aluminum Corporation, is a wholly-owned subsidiary of Alcan Aluminium Limited, a corporation organized and existing under the laws of Canada.

Alcan Aluminum Corporation's subsidiaries include Alcan-Toyo America, Inc., Alcan Sumitomo Electric, Inc., Logan Aluminum, Inc., the Aluminum Railcar Company, Polyfiltronics N.A., Inc., Ampersand Corporate Spin-off Ventures and Lanxide Corporation.

TABLE OF CONTENTS

QUESTION PRESENTED i

RULE 29.1 STATEMENT ii

TABLE OF CONTENTS iii

TABLE OF AUTHORITIES vi

OPINIONS BELOW 1

JURISDICTION 2

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED 3

STATEMENT OF THE CASE 5

THE PROCEEDINGS BELOW 8

A. The Federal Question Raised In This Case.. 8

B. The Decisions Below 8

1. The California Superior Court for the County of Los Angeles 8

2. The California Court of Appeal, Second Appellate District 9

3. The Supreme Court of California 11

REASONS FOR GRANTING THE WRIT OF CERTIORARI 12

I. INTRODUCTION 12

II. PETITIONER'S WRIT SHOULD BE GRANTED SINCE THIS CASE PRESENTS FAR MORE ISSUES UNDER THE FOREIGN COMMERCE CLAUSE THAN WERE CONSIDERED BY THE

CALIFORNIA SUPREME COURT IN *BARCLAYS BANK INTERNATIONAL, LTD. V. FRANCHISE TAX BOARD*..... 13

A. The California Supreme Court Incorrectly Presumed That Because *Barclays Bank* Did Not Have A Factual Scenario That Demonstrated An Enhanced Risk Of Multiple Taxation That It Could Never Be Demonstrated..... 15

B. The Hallmark Of The Alcan Case Is That It Has The Factual Basis To Illustrate The Unreasonable And Arbitrary Nature Of WWCR Because It Can Convincingly Demonstrate That The Tax Assessed Against It Was Out Of All Proportion To Its Business In The State..... 16

C. This Case Also Demonstrates Why AL/SA And WWCR Are Not Substantive Equivalents Simply Because Neither Are Perfect..... 22

D. Petitioner's Writ Of Certiorari Should Be Granted Because The California Supreme Court Clearly Misunderstood This Court's Reasoning In *Wardair Canada v. Florida Department Of Revenue* And Precluded Alcan From Ever Presenting Its Evidence Of Multiple Taxation..... 25

III. THE CALIFORNIA SUPREME COURT'S CONCLUSION THAT THERE IS A FEDERAL POLICY PERMITTING THE TAX IS NOT SUPPORTED BY THE OVERWHELMING EVIDENCE..... 28

CONCLUSION..... 30

APPENDIX:

Opinion of the Court of Appeal of the State of California, Second Appellate District, Division Three (November 16, 1992) A1

Order of the Supreme Court of the State of California Denying Petition for Review (February 11, 1993) A9

Statement of Decision of the Superior Court of California for the County of Los Angeles (September 30, 1991) A10

Excerpts from Stipulation of Facts A14

Joint Report by Inland Revenue and U.S. Treasury A17

TABLE OF AUTHORITIES

Cases

Alcan Aluminum Corp. v. Franchise Tax Board, No. B065648 (Court of Appeal of the State of California, Second Appellate District, Division Three, Nov. 16, 1992) 14

Barclays Bank International, Ltd. v. Franchise Tax Board, 275 Cal. Rptr. 626 (1990) 8,9

Barclays Bank International, Ltd. v. Franchise Tax Board, 829 P.2d 279 (1992), *cert. denied*, *Barclays Bank PLC v. Franchise Tax Board*, _____ U.S. _____, 113 S. Ct. 202 (1992)..... *passim*

Bass v. Tax Commission, 266 U.S. 271 (1924) 15

Butler Brothers v. McColgan, 315 U.S. 501 (1942)... 18

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) 12,25,26

Container Corp. of America v. Franchise Tax Board, 463 U.S. 159 (1983)..... 12,22,23,28

Franchise Tax Board v. Alcan Aluminium, Ltd., 493 U.S. 331 (1990)..... 7

Hans Rees' Sons v. North Carolina, 283 U.S. 123 (1931) 15

Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979)..... 8,12,25

Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance, _____ U.S. _____, 112 S. Ct. 2365 (1992) 10,27

Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980)..... 18,23

Moorman Manufacturing v. Bair, 437 U.S. 267 (1978) 19

Wardair Canada v. Florida Department of Revenue, 477 U.S. 1 (1986) ..... *passim*

Constitutional Provisions

United States Constitution, Article I, Section 8, Clause 3 3,5

Statutes

28 U.S.C. §1257(a) 2

California Revenue and Taxation Code §25101..... 3

California Revenue and Taxation Code §25137..... 3

Other Authorities

Freud, *Future of An Illusion* (1961)..... 18

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PETITION FOR WRIT OF CERTIORARI

OPINIONS BELOW

The Superior Court of California for the County of Los Angeles issued its Statement of Decision on September 30, 1991 entering judgment for Respondent Franchise Tax Board. That decision is reprinted in the Appendix at A10-A13.

The Court of Appeal of the State of California, Second Appellate District, Division Three, affirmed the lower court in an unreported decision issued on November 16, 1992, which is reprinted in the Appendix at A1-A8.

The California Supreme Court denied Petitioner's Petition for Review by Order dated February 11, 1993, which is reprinted in the Appendix at A9.

JURISDICTION

The Court of Appeal of the State of California, Second Appellate District, Division Three, affirmed the decision of the Superior Court for the County of Los Angeles on November 16, 1992.

Petitioner timely filed a Petition for Review in the Supreme Court of California on December 23, 1992. That Petition for Review was denied on February 11, 1993, thereby rendering final the decision of the Court of Appeal. Petitioner presently seeks review of those orders.

The jurisdiction of the Supreme Court of the United States is invoked pursuant to 28 U.S.C. §1257(a).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

United States Constitution, Article I, Section 8, Clause 3 (the Commerce Clause) provides that:

> [The Congress shall have Power] To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.

California Revenue and Taxation Code §25101 states:

> §25101. Basis of allocation
>
> When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 (commencing with Section 25120). However, any method of apportionment shall take into account as income derived from or attributable to sources without the state, income derived from or attributable to transportation by sea or air without the state, whether or not the transportation is located in or subject to the jurisdiction of any other state, the United States or any foreign country.
>
> If the Franchise Tax Board reapportions net income upon its examination of any return, it shall, upon the written request of the taxpayer, disclose to it the basis upon which its reapportionment has been made.

California Revenue and Taxation Code §25137 states:

> §25137. Proceedings where allocation and apportionment provision fail to fairly represent taxpayer's business activity in state
>
> If the allocation and apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the

taxpayer may petition for or the Franchise Tax Board may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) Separate accounting;

(b) The exclusion of any one or more of the factors;

(c) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

STATEMENT OF THE CASE

This is an action seeking the refund of franchise taxes paid to the State of California during the years 1965 through 1971. The franchise tax was computed by the unitary or formulary method of taxation, also referred to as worldwide combined reporting ("WWCR"), applied to a non-domiciled foreign parent combination. It is Petitioner Alcan Aluminum Corporation's ("Alcan") contention that such a tax violates the foreign Commerce Clause of the United States Constitution, Article I, Section 8, Clause 3. Alcan is a wholly owned subsidiary of Alcan Aluminium Limited ("Limited"), which is a corporation organized and existing under the laws of Canada. Limited's headquarters and principal place of business are in Montreal, Quebec, Canada. Limited and various of its subsidiaries are engaged in all phases of the aluminum business on an international scale. Neither Limited nor its non-United States subsidiaries have a permanent establishment in the United States.

Alcan, the Petitioner in this case, was at the time in question a corporation organized and existing under the laws of the State of New York with its principal place of business in Cleveland, Ohio. Alcan and its subsidiaries are engaged in the business of fabricating and selling various aluminum products in the United States. Certain activities of Alcan are conducted in the State of California.

The Respondent in this case is the Franchise Tax Board of the State of California ("FTB"). Since 1965, the FTB has assessed franchise taxes on Alcan for doing business in the State of California on what is known as a "unitary" basis. Under this method of taxation, the income of the unitary business attributable to California is calculated by a three-factor formula which multiplies

the total worldwide income of Limited by the relative percentage of that business' property, payroll and sales in California.

The result of WWCR is that FTB has measured and assessed franchise taxes not solely on the income of Alcan and its United States affiliates, but also on the worldwide income of Limited and all of Limited's non-United States subsidiaries (the "Alcan Unitary Business"). The purpose and effect of the Respondent's actions are to greatly inflate the amount of tax assessed and collected by attributing to California a portion of the worldwide income of Limited and its non-United States subsidiaries all of whom have no permanent place of business in the United States and all of their income is subject to the tax rules of the host country in which they conducted business and in Canada upon distribution.

The effect of this taxation is to tax the income of Limited and its non-United States subsidiaries multiple times and effectively to tax Limited's non-United States foreign operations. In addition, it has the potential to impose substantial costs of compliance upon Limited and its non-United States subsidiaries. The existence of multiple taxation and the absence of a sufficient nexus upon which to predicate a tax on activities that take place exclusively in foreign commerce, as well as the discriminatory impact of the compliance burden, constitute a violation of the foreign Commerce Clause. Finally, because of the foregoing and because of the international understanding that the taxation of foreign subsidiaries must be done exclusively on an arm's length/separate accounting ("AL/SA") basis, the Respondent's method of taxation interferes with the foreign policy of the United States and its ability to "speak with one voice," again violating the foreign Commerce Clause of the United States Constitution.

In 1984, Limited commenced an action in the Federal District Court for the Northern District of Illinois. The purpose of that action was to seek an injunction and declaratory judgment that the present tax violated the foreign Commerce Clause of the United States Constitution. This case was held in abeyance by agreement between the parties pending the resolution of the federal action. In 1990, this Court rendered an Opinion that held that the federal action was tentatively barred by the Tax Injunction Act on the presumption that Alcan could raise and have adjudicated in its refund action in the California courts all of the injuries to Limited. *Franchise Tax Board v. Alcan Aluminium, Ltd.*, 493 U.S. 331 (1990). As a result of that ruling by this Court, the present case proceeded.

Alcan raises essentially the same constitutional issues in this case that Limited had raised in the federal action. The parties filed cross motions for summary judgment based on stipulations of fact. The Los Angeles County Superior Court entered judgment for FTB and Alcan appealed. The Second Appellate District, Division Three of the Court of Appeals of the State of California affirmed the trial court on November 16, 1992. Alcan duly filed its Petition for Review with the California Supreme Court on December 23, 1992. That Petition for Review was denied on February 11, 1993. Alcan now seeks to have this Honorable Court grant its Petition for a Writ of Certiorari so that this Court may address the essential constitutional issues raised by this appeal.

THE PROCEEDINGS BELOW

A. The Federal Question Raised In This Case

In Petitioner's pleadings and briefs in the California Superior Court for the County of Los Angeles, in its Briefs in the California Court of Appeal, Second Appellate District, Division Three, and in its Petition for Review to the California Supreme Court, Alcan contended that the Respondent's use of WWCR as applied to a non-domiciled foreign parent combination violated the Commerce Clause of the United States Constitution.

B. The Decisions Below

1. *The California Superior Court for the County of Los Angeles*

The Los Angeles Superior Court entered judgment for Respondent relying on this Court's reasoning in *Wardair Canada v. Florida Department of Revenue,* 447 U.S. 1 (1986), which held that there was no need for the Court to undertake a dormant commerce clause analysis since "having failed to preclude the States' use of [WWCR], Congress has, by clear negative implication, authorized its use by the states." A11.

Further, the Los Angeles Superior Court cited the decision of the California Court of Appeal for the Third Appellate District in *Barclays Bank International, Ltd. v. Franchise Tax Board,* 275 Cal. Rptr. 626 (1990), which held that the use of WWCR is unconstitutional under the dormant commerce clause analysis as set out in *Japan Line Ltd. v. County of Los Angeles,* 441 U.S. 434 (1979) A11. The Los Angeles Superior Court, however, stated that "[t]aken together the five factors advanced in *Barclays Bank* demonstrate a legislative intent on the

part of Congress not to restrict the states' use of [WWCR]. The same factors are urged here and the presence of the fifth presents an *a fortiori* case to *Wardair* itself." A12,A13.

The Los Angeles Superior Court concluded that "the facts presented here do not present any case specific circumstances that differentiate this action from *Barclays Bank* or the [Alcan] action in the Sacramento Superior Court, as far as the application of the dormant commerce clause constitutionality analysis versus the reasoning of *Wardair* is concerned, and the determination forthcoming in the [California] Supreme Court [in the *Barclays* case] will, in all likelihood, be dispositive in this action upon appellate review." A13.

2. ***The California Court of Appeal, Second Appellate District***

The Court of Appeal affirmed the decision of the Los Angeles Superior Court relying on the California Supreme Court's opinion in *Barclays Bank International Ltd. v. Franchise Tax Board*, 829 P.2d 279 (1992), *cert. denied, Barclays Bank PLC v. Franchise Tax Board*, _____ U.S. _____, 113 S. Ct. 202 (1992),[1] which held that a "dormant commerce clause analysis is not appropriate where the federal government has acted in

[1] The California Supreme Court remanded the *Barclays* case to the Court of Appeal on the issue of the discriminatory effect of the compliance burdens on the Commerce Clause and the due process issue. While the remand was pending, Barclays sought review by this Court. That Petition was denied on October 5, 1992. The Court of Appeal rendered its decision on remand on November 20, 1992 and denied a Petition for Rehearing on December 18, 1992. The California Supreme Court denied a Petition for Review on February 18, 1993. Barclays has since filed a Petition for Writ of Certiorari to this Court, which is pending.

such a manner as to acquiesce in the states' use of worldwide formula apportionment." A5. Quoting *Barclays*, 829 P.2d at 294, the Court of Appeal stated:

> In our view, Congress, after being repeatedly pushed and pulled in both directions, at least for the present has decided *not* to prohibit state use of formula apportionment in cases of this kind. To paraphrase the *Wardair* [*Wardair Canada v. Florida Dept. of Revenue* (1986) 477 U.S. 1] opinion, international agreements demonstrate that the federal government has affirmatively acted, rather than remained silent, with respect to the power for the states to employ formula apportionment in so-called foreign parent cases; as a result, this case does not call for dormant foreign commerce clause analysis at all. [Citation.]

A5.

The Court of Appeal further stated that "[t]he *Barclays* Court rejected the sort of material claimed by [Alcan] and by *amici curiae* on its behalf, to evidence a 'clear federal directive' sustaining its dormant commerce clause case." A7. Again quoting *Barclays*, 829 P.2d at 295, the Court of Appeal found that "[r]ather than qualifying as a 'clear federal directive,' these materials, in the context of Congress's [sic] persistent refusal to regulate state taxation of multinationals and the Senate's explicit rejection of article 9(4) of the United States-United Kingdom treaty, embody nothing more than executive aspirations of what the federal government's policy in this area *ought* to be." A7.

The Court of Appeal also rejected the application of this Court's ruling in *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance*, _____ U.S. _____, 112 S. Ct. 2365 (1992) holding that the decision "has nothing to do with the question whether the dormant

foreign commerce clause precludes imposition by a state of a unitary tax based on the worldwide income of a multinational corporate taxpayer." A8.

3. *The Supreme Court of California*

Alcan filed a Petition for Review in the Supreme Court of California on December 23, 1992, which was denied without opinion on February 11, 1993, thereby rendering final the decision of the Court of Appeal in favor of Respondent, Franchise Tax Board.

REASONS FOR GRANTING THE WRIT OF CERTIORARI

I. INTRODUCTION.

The utilization of the unitary method of taxation has been a matter of international controversy since it was adopted and applied by California over a quarter of a century ago. This Court reviewed the application of this tax to domestic parent combinations in *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983). In that case, this Court explicitly excepted from its holding the question of whether the tax was unconstitutional as applied to foreign parent combinations. As a practical matter, a final resolution of this controversy has awaited a determinative statement by this Court concerning the constitutionality of this method of taxation. This case presents the opportunity to address this issue *both* with respect to whether the tax creates a substantial risk of multiple taxation and whether the tax prevents the Federal Government from "speaking with one voice"as outlined by this Court in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), as well as whether this tax conflicts with the constitutional standards of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

II. PETITIONER'S WRIT SHOULD BE GRANTED BECAUSE THIS CASE PRESENTS FAR MORE ISSUES UNDER THE FOREIGN COMMERCE CLAUSE THAN WERE CONSIDERED BY THE CALIFORNIA SUPREME COURT IN *BARCLAYS BANK INTERNATIONAL, LTD. V. FRANCHISE TAX BOARD.*

In *Wardair Canada v. Florida Department of Revenue,* this Court noted that there were six critical questions in determining whether or not there was a violation of the foreign Commerce Clause:

> When a state tax is challenged as violative of the dormant Interstate Commerce Clause, we have asked four questions: is the tax applied to an activity with a substantial nexus with the taxing State; is the tax fairly apportioned; does the tax discriminate against interstate commerce; and is the tax fairly related to the services provided by the State. *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 279 (1977). In *Japan Line,* [441 U.S. 434, 451 (1978)], we noted that when the state tax allegedly interferes with the Federal Government's authority to regulate foreign commerce, two additional questions must be asked: "first, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation, and, second, whether the tax prevents the Federal Government from speaking with one voice when regulating commercial relations with foreign governments."

477 U.S. 1, 8 (1986).

In *Barclays Bank International Ltd. v. Franchise Tax Board,* 829 P.2d 279 (1992), *cert. denied, Barclays Bank PLC v. Franchise Tax Board,* _____ U.S. _____, 113 S. Ct. 202 (1992), the California Supreme Court resolved the constitutional question by looking at

essentially one issue, the "speaking with one voice" aspect of this six part test. This resulted from the fact that the Bank was simply unable to present a factual context that was capable of demonstrating that WWCR offended numerous other elements of the six part test. By relying inappropriately on this Court's logic in *Wardair*, the *Barclays'* Court reasoned tautologically that Congress had approved the tax which thereby precluded Alcan from demonstrating that numerous other parameters in a complete Commerce Clause analysis were offended by the tax as it applied to Alcan. The Second Appellate Department reasoned in this respect:

> Alcancorp urges application of the dormant foreign commerce doctrine to the facts of this case. Under this doctrine, state action affecting interstate and foreign commerce may be limited even where Congress has failed to exert its plenary commerce clause power.
>
> *Barclays* . . . held dormant commerce clause analysis is not appropriate where the federal government has acted in such a manner as to acquiesce in the states' use of worldwide formula apportionment.

Alcan Aluminum Corp. v. Franchise Tax Board, No. B065648, slip op. at 5-6 (Court of Appeal of the State of California, Second Appellate District, Division Three, Nov. 16, 1992) (citations omitted) A4, A5. As Petitioner will demonstrate, the *Barclays* Court improperly reasoned from *Wardair* the result of which was to again deny Alcan the opportunity to present the factual context of its case which has been pursued by it and its parent, Limited, through the courts for over a decade.

A. The California Supreme Court Incorrectly Presumed That Because *Barclays Bank* Did Not Have A Factual Scenario That Demonstrated An Enhanced Risk Of Multiple Taxation That It Could Never Be Demonstrated.

The California Supreme Court in *Barclays* began its analysis by extrapolating from the reasoning of this Court and concluding that separate accounting could not, standing alone, impeach the use of the formulary method's accuracy in determining the tax. This Court has evolved a doctrine that makes it exceedingly difficult to demonstrate the existence of multiple taxation as a result of the use of WWCR. This does not mean that multiple taxation does not occur, nor that it is not massive in its impact. The problem results from the fact that this Court's logic is somewhat circular. If this Court fails to grant certiorari in this case, it will have precluded Alcan and presumably other foreign nationals from demonstrating the existence of multiple taxation as a result of WWCR simply because Barclays Bank, through no fault of its own, failed to do so.

The California Supreme Court in *Barclays* concedes that the unitary method of taxation can be constitutionally impeached if it can be shown that it "produce[s] an unreasonable result." 829 P.2d at 284 (quoting *Bass v. Tax Comm.*, 266 U.S. 271, 282-283 (1924)). The Court goes on to note that either AL/SA or WWCR is constitutionally permissible "as long as the [method] chosen does not operate 'unreasonably and arbitrarily' to attribute to the taxing state a percentage of total income 'out of all proportion to the business transacted by the [taxpayer] in that State.' " 829 P.2d at 285 (quoting *Hans Rees' Sons v. North Carolina*, 283 U.S. 123, 135 (1931)). However, after concluding that

Barclays failed to meet its burden in this respect, the California Supreme Court undertook to develop a doctrine that would effectively preclude every challenge to the tax regardless of the quality of the facts and the unreasonable and arbitrary nature of the tax by developing a doctrine that precludes consideration of the impact.

B. The Hallmark Of The Alcan Case Is That It Has The Factual Basis To Illustrate The Unreasonable And Arbitrary Nature Of WWCR Because It Can Convincingly Demonstrate That The Tax Assessed Against It Was Out Of All Proportion To Its Business In The State.

There is a simple reason why the AL/SA standard is the international standard. Since it is a market based standard, albeit not perfect, it is immune from the systematic manipulation of the party who stands to benefit from the formula's application. From the perspective of a multinational, Limited would have no objection to the use of a formula provided there was one agreed upon by all nations. The reason there is no agreement on a formula is because in the international context there are such great variations in economic systems and accounting standards that nations are unable to agree upon one. In a sense, the AL/SA standard has become the standard by default. The California Supreme Court took great pains to survey the history of this Court's comments on the legal equivalence of AL/SA with the formulary method. However, it was equally careful to articulate a doctrine which insures that contrary facts that might question the constitutional validity of WWCR in the foreign context, notwithstanding the fact that this Court reached its conclusions exclusively in the context of United States businesses, could never be considered.

Under the *Barclays* circumstances, it was impossible to demonstrate the extreme potential for massive double taxation for two reasons. First, *Barclays* had only a small portion of its potential WWCR liability at stake in the years at issue. Second, since separate accounting had been impugned as a basis for impeaching the unitary method, it left only rare instances in which the real economic impact of the tax might be demonstrated. The Alcan case presents just such an instance where the conclusion that WWCR was clearly taxing foreign income is inescapable. It was rare because the business operation had to be effectively destroyed in order to make the point. These facts present not only an opportunity for this Court to view in real economic terms the fundamental basis for the international objections to the tax, but also present this Court with an opportunity to reevaluate the limitations it has imposed on challenges to these taxes, and to develop a more realistic and fair standard for challenging such formulas in the foreign context.

The problem with the present state of the law with respect to impeaching formulas is that this Court does not present an objective standard upon which to evaluate a formula's fairness. The problem arises because this Court starts its reasoning with the proposition that formulas are justified because separate accounting permits companies to shift "undetectable"[2] sources of income in a manner that avoids taxation. However, as Sigmund Freud noted with respect to religion, this reasoning has the characteristics of being incapable of being proven or refuted:

---

[2] If these values were detectable and quantifiable, AL/SA could not be impeached since these values could simply be used to adjust the AL/SA result.

> Of the reality value of most of [religious beliefs] we cannot judge; just as they cannot be proved, so they cannot be refuted.

S. Freud, *Future of An Illusion*, 31 (1961).

The result is that the primary method for criticizing formula apportionment, separate accounting, becomes virtually useless because no matter how dramatic the difference between the AL/SA method and the WWCR method, the AL/SA method is suspect on the grounds that it is not accurately reflecting income since hidden values are escaping detection. This Court has reasoned in this vein in the past when it rejected an attack on a distorted formulary result. It concluded that since it had approved the formulary apportionment method because it believed that AL/SA missed significant but "unidentifiable" value, any distortion revealed by the AL/SA method must be suspect:

> In these circumstances [a unitary business], the Court has noted that separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale.

Mobil Oil Corp. v. Comm'r of Taxes, 445 U.S. 425, 438 (1980) (citing *Butler Bros. v. McColgan*, 315 U.S. 501, 508-509 (1942)).

Although it is true that a separate accounting method may not accurately measure these factors, it is equally true that it may. Since the present doctrine that this Court has adopted simply assumes that separate accounting never accurately measures these factors, any attempt to use it to impeach a formulary method is almost always destined for failure at the outset. This

case, however, presents a rare set of facts which shows the distorting effect of WWCR without reliance on AL/SA.

Alcan's franchise tax liability for the years in question arose primarily from the Riverside, California manufacturing operation. Alcan acquired the facility in 1965, along with assets in New York and New Jersey when it was formed by Limited. The Riverside facility was acquired from National Distillers and Chemical Corporation. At the time of its acquisition, the operation had been losing money on a separate accounting basis and was sold to Alcan at a market price that reflected that fact.

Alcan had great hopes that it could revive the facility and that it could be made profitable as a result of the expertise developed in the international sales and marketing operation of Limited.[3] Those hopes proved to be illusory. The facility continued to lose money as part of the Alcan operation and was finally closed in 1977. The Riverside facility was unquestionably an unprofitable operation in large measure due to its structure and organization. Early in Alcan's ownership, the United States Justice Department had concluded that Alcan's ownership of the Riverside facility raised antitrust concerns. The matter was resolved when Alcan entered into a consent decree to sell the facility. All of these events combined to independently confirm what the AL/SA numbers had, in fact, accurately represented as the actual economic status of Alcan's Riverside facility: California's formula was taxing the facility "out of all appropriate proportion to the business transacted . . . in that State." *Barclays*, 829 P.2d at 285 (quoting *Moorman Mfg. v. Bair*, 437 U.S. 267, 274 (1978)).

[3] This was, in a sense, a unitary operation in reverse where the California operation was to benefit from activities in other countries.

Alcan's attempts to sell the facility as required by the consent decree proved futile. It soon became apparent that the facility had no going concern value; that is the value which reflects the facility's ability to produce income. After making numerous efforts to sell the facility or make it profitable, Alcan management finally had to acknowledge that the facilities were simply incompatible with the reality of the contemporary marketplace. Managements' conclusions in this regard were recorded in the mid 1970's in the Request For Authorization to scrap the facility referred to in paragraph 14 of the Stipulation of Facts (Exhibit XXI):

> The Riverside sheet products operation has lost money in every year since 1972, averaging some $900,000 of loss before interest and tax per year during the last four years.
>
> The current Annual Plan predicts a loss of $1.3 million in 1976 and a further loss of $0.7 million next year (after interest but before tax). Sales and booking volumes are running about 10% under plan levels so a substantial additional loss, perhaps up to $0.2 million, can be anticipated . . .
>
> * * *
>
> With a few exceptions, the Riverside equipment is narrow and obsolete. Due to the growth pattern of the facility, the layout is inefficient and the "wide" casting and hot rolling line is too narrow even for double width siding. Any modernization program to increase width capabilities beyond 26" would have to embrace almost the entire plant and would probably cost as much as or more than starting on a green fields basis. The California market would not justify this sort of expenditure.

Stipulation of Facts, Exhibit XXI, *Alcan Aluminum Corp. v. Franchise Tax Board*, No. C-196604 (Cal. Sup. Ct., County of Los Angeles, Sept. 30, 1991) A14, A15.

The theory of unitary taxation is that unitary businesses shift income in a way that does not accurately reflect the real earnings in the state. However, the foregoing example demonstrates the dramatic failure of that theory when applied in the context of a foreign parent combination. It is absolutely clear that both the independent market place and the company recognized that the facility was not profitable because it was "obsolete". It was also well understood that the nature of the California market made any additional investment uneconomical. Given these facts, it is patently clear that California's economic climate and the physical state of the facility made it impossible for the Riverside facility to ever operate in a fashion that would result in overall profitability. In fact, that is precisely what the separate accounting numbers demonstrated. The formulary method, however, treated the facility as though it was highly profitable when it was, in fact, clearly losing money.

If Alcan had not been under an obligation to put the property on the market, the evidence that it had no going concern value independent of AL/SA, would not have been available. If the facility had not in fact been unprofitable, but instead had produced a reasonable income, just not nearly as much as the formulary method attributed to it, then Alcan would not have closed the facility. Under these circumstances and under the California Supreme Court's interpretation of this Court's reasoning, there would have been no basis to impeach the formulary method, even though the distorting effects of the tax might even have been more severe. Thus, in *Barclays*, when the Bank was unable to demonstrate that the tax was excessive when related to its activities in California, it was not because that was not true, but

simply because, through no fault of its own, it did not have the facts that Alcan had experienced through a series of different events.

Not only does this case present the facts that highlight the real impact of WWCR, but it also demonstrates that the formula-generated tax is being imposed upon income generated wholly outside the United States, which was already subject to taxation by the nation in which it was earned.

C. This Case Also Demonstrates Why AL/SA And WWCR Are Not Substantive Equivalents Simply Because Neither Are Perfect.

The California Supreme Court in *Barclays* lifted this Court's statements from *Container Corp.* to conclude that since both AL/SA and WWCR could result in double taxation, the two methods are substantively interchangeable in all situations:

> The court [this Court] first noted that 'allocating income among various jurisdictions bears some resemblance . . . to slicing a shadow,' and concluded that 'it would be perverse, simply for the sake of avoiding double taxation, to require California to give up one allocation method that sometimes results in double taxation [i.e., formula apportionment] in favor of another method [i.e., AL/SA] that also sometimes results in double taxation.'

Barclays, 829 P.2d at 288 (citing *Container Corp.*, 463 U.S. at 192-193).

This reasoning is flawed. There is very little in life that operates perfectly in practice; however, there are very significant distinctions that can be made on the underlying theory and the empirical evidence that supports a particular allocation scheme. For example, as

an economic issue there is no fundamental economic difference between *Container Corp.* and *Mobil Oil.* Both involved the allocation of United States value. The fact that the foreign dividends in *Container Corp.* had not been repatriated as an accounting event does not change the fundamental economic nature of the case since the value of those dividends was immediately reflected in the increased net worth of the parent, Container Corporation. Thus, the substantive equivalence of the formulary method and the AL/SA method in *Container Corp.* was in the context of a single United States economic climate to which both methods had demonstrated a reasonable empirical and theoretical relevance. What the Riverside example illustrates is what occurs when WWCR is applied in a context where the formula has not been demonstrated to have the same relevance in terms of how income is generated among widely varied economic cultures. Clearly, the more socialistic the system, the less relevant payroll becomes in reflecting profit generation.

AL/SA is imprecise in its allocation of income between nations but that imprecision stems from the imperfection in measurement not the irrelevance of the allocation scheme. The California Supreme Court treats measurement imperfection as the substantive equivalent of a method of allocation for legal purposes and that, in our view, is both a legal and common sense mistake.

The fallacy in the California Supreme Court's logic might be illustrated by reference to the physical sciences. High school and college physics courses teach that there are two well-known methods of explaining how matter behaves. On the macro-level, there are the well-known principles of Newtonian mechanics. At the subatomic particle level, however, there are principles referred to as Quantum mechanics. Even though both disciplines are

relationships between the same matter, the principles of each discipline are distinctly different. These principles are expressed by formulas similar in kind to apportionment formulas.

In measuring physical events in both macro and subatomic levels, the instrumentation is by its nature inaccurate. Obviously, improvements have taken place over time, but nothing is perfect. However, it would be highly inappropriate to use a Newtonian formula to explain a subatomic event simply because the instrumentation is inaccurate. Quantum mechanics was developed because it became clear by empirical investigation that Newtonian mechanics did not explain subatomic events even if there might be some superficial similarity. Thus, a formula which explains what happens with the cue ball on a billard table on the break shot of a game, is not appropriate for explaining what happens when protons are accelerated into an atomic nucleus.

Similarly, from an economic perspective, a formula which relies on wage rates, capital (property) costs and the market value of sales in a third world country where labor is very cheap and used instead of capital and the cost of living is very low, will have equally as little relevance to how profits are generated as the cue ball formula does to the atomic nucleus. The Riverside example illustrates these facts.

D. Petitioner's Writ Of Certiorari Should Be Granted Because The California Supreme Court Clearly Misunderstood This Court's Reasoning In *Wardair Canada V. Florida Department Of Revenue* And Precluded Alcan From Ever Presenting Its Evidence Of Multiple Taxation.

It has been the hallmark of Alcan's case that the WWCR violates the Commerce Clause because it offends the principles that this Court has enunciated in *Complete Auto* and *Japan Line.* This case presents the factual context to illustrate that fact. The California Supreme Court has refused to consider Alcan's facts because it held, in effect, that since Congress failed to explicitly prohibit that which might otherwise be prohibited as a matter of law, Congress really has permitted the activity. This peculiar logic is predicated on a clear misreading of *Wardair.* In *Wardair*, this Court did not conclude that a dormant Commerce Clause analysis was not appropriate because Congress had acted to permit the tax. Rather, this Court concluded that the case was not appropriate for a dormant Commerce Clause analysis because both of the parties agreed that none of the elements for such an analysis existed:

> In the present case, appellant concedes that Florida's tax satisfies the four-part test set out in *Complete Auto.* In other words, it is not disputed that if this case did not involve foreign commerce, the Florida tax on the sale of aviation fuel would not contravene the Commerce Clause. Appellant also recognizes that there is no threat of multiple international taxation in this case, since the tax is imposed only upon the sale of fuel, a discrete transaction which occurs within one national jurisdiction only. Appellant and the United States as *amicus curiae* thus rely entirely on the final factor identified in *Japan Line,* and argue that the

> Florida tax violates the Foreign Commerce Clause because it threatens the ability of the Federal Government to 'speak with one voice.'

Wardair, 477 U.S. at 8-9.

It is one thing to say that an otherwise completely constitutional tax is not unconstitutional because the federal government has not acted in a way that convincingly suggests that the tax interferes with its foreign relations, and even appears to countenance the tax by a failure to prohibit it. That is essentially a proof issue and this Court concluded that *Wardair* failed to meet its burden to establish a federal policy. It is quite another thing, however, to suggest that the failure of the federal government to act to prohibit a tax that is otherwise illegal because it offends the elements of *Complete Auto* can be converted to the legal equivalent of a statutory expression by the Congress and the Executive that the tax has been authorized. That is precisely what the California Supreme Court did in *Barclays* and this Court should review its action for two reasons. First, it clearly conflicts with this Court's explicit requirement that Congress may only permit activities that would otherwise offend the Commerce Clause by explicit statutory action even when it appears to be consistent with United States policy. In reviewing an Iowa unitary tax scheme which discriminated against foreign commerce by including foreign dividends in the tax base and not including dividends from United States subsidiaries, this Court held that absent explicit statutory authorization, the tax cannot avoid a Commerce Clause analysis even if it is otherwise consistent with United States policy:

> Iowa need not adopt the federal definition of taxable income. Nor, having chosen to follow the federal system in part, must Iowa duplicate that scheme in

> all respects. The adoption of the federal system in whole or in part, however, cannot shield a state tax statute from Commerce Clause scrutiny. The Iowa statute cannot withstand the scrutiny, for it facially discriminates against foreign commerce and therefore violates the Foreign Commerce Clause.

Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue and Fin., _____ U.S. _____, 112 S. Ct. 2365, 2372 (1992).

Second, the California Supreme Court's decision sets a dangerous precedent because it permits courts to insert their judgments as to why Congress did not act and convert that judgment to the equivalent of legislation. This is not only judicial legislation in its grossest form, it takes the entire notion of courts usurping the role of the legislature a step further by permitting a state court to elevate its judgment to legal equivalent of a federal statute.

III. THE CALIFORNIA SUPREME COURT'S CONCLUSION THAT THERE IS A FEDERAL POLICY PERMITTING THE TAX IS NOT SUPPORTED BY THE OVERWHELMING EVIDENCE.

It should be clear to this Court from the foregoing that AL/SA, which this Court acknowledged in *Container Corp.*, is the international standard. That is not as much a matter of choice as it is of necessity. Since nations are unable to agree on a formula, the AL/SA method which relies on the market place as the ultimate arbiter of where profits are earned becomes the policy of nations by default as well as by choice. The lower courts in these cases have had numerous nations, including the United States, appear before them in both the *Alcan* and *Barclays* cases and insist that their common understanding of United States policy is that federal taxation of subsidiaries of foreign nations must be limited to the AL/SA standard.

The California Supreme Court's conclusion in *Barclays* that Congress' failure to explicitly prohibit the tax means Congress intended to approve it, is flawed. There are numerous other more plausible explanations for congressional inaction. One of the most obvious is that there is no need to prohibit that which is already illegal. The federal government's explicit statement of intent to pursue the matter through the courts certainly supports that view. *See* Joint Report by Inland Revenue and U.S. Treasury, Unitary Tax, December, 1991 Report, reprinted in Appendix at A17-A37.

The facts do not support the position of the California Supreme Court that the failure of article 9(4) of the United States-United Kingdom treaty indicates that Congress intended to permit the tax. *See Barclays,*

829 P.2d at 294. It is quite clear that there were never enough votes to pass a statutory authorization for the tax as illustrated by the small margin by which the treaty provision failed to get the required two-thirds vote. Moreover, the California Supreme Court tragically misinterprets the restrained attempts by the federal government to persuade California to get in line with the international community as a sign that the tax is condoned. The California Supreme Court seems to be saying that all they respond to is force.

Finally, the California Supreme Court's reliance on *Wardair* is misplaced. In that case, it was clear that the tax involved was a perfectly appropriate tax absent a clear and explicit preclusion by federal action. These facts are dramatically different. Here it is clear that foreign income is pulled into the California tax base to determine the California liability. The unitary tax theory is not limited to taxing a discrete event in the state, but determining the liability of the entire international business to California. Under the circumstances there is no support for the notion that California's characterization of federal policy is correct.

CONCLUSION

For all of the foregoing reasons, Alcan respectfully requests that this Honorable Court issue a Writ of Certiorari to the Court of Appeal of the State of California in and for the Second Appellate District.

Respectfully submitted,

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APPENDIX

OPINION OF THE COURT OF APPEAL OF THE STATE OF CALIFORNIA, SECOND APPELLATE DISTRICT, DIVISION THREE

(Filed November 16, 1992)

NOT TO BE PUBLISHED

B065648
(Super.Ct.No.C196604)

IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION THREE

ALCAN ALUMINUM CORPORATION,
Plaintiff and Appellant,

v.

FRANCHISE TAX BOARD OF THE
STATE OF CALIFORNIA,
Defendant and Respondent.

APPEAL from a judgment of the Superior Court of Los Angeles County. Kurt J. Lewin, Judge. Affirmed.

Patricia Shuler Schimbor, Salvador A. Casente, Jr., William D. Rauch, Jr., and Hancock, Rothert & Bunshoft for Plaintiff and Appellant.

F. Eugene Wirwahn, Gene R. Gambale, and Arter, Hadden, Lawler, Felix & Hall for Amicus Curiae on behalf of Plaintiff and Appellant.

James A. Bruton, Acting Assistant Attorney General, Gary R. Allen, David English Carmack, John J. McCarthy and Lourdes G. Baird, United States Attorney, for Amicus Curiae on behalf of Plaintiff and Appellant.

Daniel E. Lungren, Attorney General of the State of California, Timothy G. Laddish, Senior Assistant Attorney General, Edmond B. Mamer, Superivising Deputy Attorney General, Philip C. Griffin, Deputy Attorney General, for Defendant and Respondent.

INTRODUCTION

Plaintiff taxpayer Alcan Aluminum Corporation (Alcancorp) brought this refund action to recover assessments totalling $1,720,615.94 levied against it by the Franchise Tax Board for the 1965 through 1971 tax years.

Following a bench trial on stipulated facts and issues, the superior court ruled in favor of the Franchise Tax Board. Alcancorp appeals.

ISSUE

The sole issue presented by this appeal is whether the Franchise Tax Board (Board) properly may measure the unitary tax (Rev. & Tax. Code, §25101 et seq.)[1]

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[1] Revenue and Taxation Code section 25101 provides in part: "When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 (commencing with Section 25120)."

(Footnote continued on following page.)

imposed upon Alcancorp, a New York corporation having its principal place of business in Ohio, based on the worldwide income of Alcancorp's parent, Alcan Aluminum [sic] Limited (Aluminium), a Canadian corporation headquartered in Montreal, and all of its subsidiaries, including non-United States subsidiaries.[2]

DISCUSSION

The issue was determined in the Board's favor in the very recent decision of our Supreme Court in *Barclay's Bank Internat., Ltd. v. Franchise Tax Bd.* (1992) 2 Cal.4th 708.

1. *Unitary Taxation*

In *Barclay's, supra*, the court explained that the " 'three-factor' " model employed by the Board "defines the multijurisdictional scope of the unitary enterprise of which the taxable intrastate activities are a part, calculates the combined income of the components of the

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(Footnote continued from preceding page.)

"Section 25120 et seq. of the Revenue and Taxation Code is California's version of the Uniform Division of Income for Tax Purposes Act (UDITPA; see 7A West's U. Laws Ann. (1985) p. 331); . . . the statute authorizes the use of a three-factor formula to apportion the net income from a taxpayer's total business activities in order to determine the net income attributable to intrastate activities. (. . .; Rev. & Tax. Code, §§25120-25140.)" (*Barclay's Bank Internat., Ltd. v. Franchise Tax Bd.* (1992) 2 Cal.4th 708, 713, fn. 1.)

[2] Alcancorp also challenges the propriety of the unitary method of accounting on due process grounds, claiming compliance would impose an undue administrative burden on Aluminum [sic]. This ground was waived by Alcancorp's stipulation in the trial court: "For purposes of this litigation, Alcan is not contesting the Board's determination that the Alcan Group Companies constitute a single unitary business under the tests formulated by the California Courts and the United States Supreme Court, or contending that the tax assessed violated the Due Process Clauses of the United States Constitution or the California Constitution."

unitary group, and distributes a portion of that result to the taxing state using a mathematical formula based on an averaged ratio of property, payroll, and sales in the taxing jurisdiction to that of the unitary enterprise overall. [Citation.]" (*Id.*, at p. 715, fn. omitted.)

"So far as taxation of United States-derived income is concerned, the use of formula apportionment is both established and noncontroversial, being the preferred method of a majority of the states; a substantially smaller number of American jurisdictions—California among them—combine and apportion the *worldwide* income of multinational corporate taxpayers, a variant sometimes referred to as the 'worldwide combined reporting' or 'WWCR' method." (*Id.*, at pp. 715-716, fn. omitted.)

2. *The Doctrine Of The "Unexercised," "Negative," Or "Dormant" Foreign Commerce Clause*

Alcancorp urges application of the dormant foreign commerce clause doctrine to the facts of this case. Under this doctrine, state action affecting interstate and foreign commerce may be limited even where Congress has failed to exert its plenary commerce clause power. (*Barclay's, supra*, 2 Cal.4th at p. 722.) Where the doctrine applies, the courts have adopted various tests "to evaluate state tax schemes to ensure compliance with the inherent demands of the 'unexercised' commerce clause." (*Id.*, at p. 723.) Thus, in *Complete Auto Transit, Inc. v. Brady* (1977) 430 U.S. 274, the court held that a tax which "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State,' . . . does not burden

impermissibly interstate commerce. (Citation.)" (*Barclay's, supra*, 2 Cal.4th at p. 723.) And *Japan Line, Ltd. v. County of Los Angeles* (1979) 441 U.S. 434, held a court must also inquire "'. . . whether the tax, notwithstanding apportionment, creates a substantial risk of international *multiple taxation*, and . . . whether the tax prevents the Federal Government from "speaking with *one voice* when regulating commercial relations with foreign governments." If a state tax contravenes either of these precepts, it is unconstitutional under the . . . Commerce Clause." [Citation.]" (*Barclays, supra*, 2 Cal.4th at p. 723, original italics.)

Alcancorp seeks application of these tests to the tax imposed upon it.

3. *The Dormant Foreign Commerce Clause Doctrine Does Not Apply*

Barclay's, supra, held dormant commerce clause analysis is not appropriate where the federal government has acted in such a manner as to acquiesce in the states' use of worldwide formula apportionment. "In our view, Congress, after being repeatedly pushed and pulled in both directions, at least for the present has decided *not* to prohibit state use of formula apportionment in cases of this kind. To paraphrase the *Wardair* [*Wardair Canada v. Florida Dept. of Revenue* (1986) 477 U.S. 1] opinion, international agreements demonstrate that the federal government has affirmatively acted, rather than remained silent, with respect to the power of the states to employ formula apportionment in so-called foreign parent cases; as a result, this case does not call for dormant foreign commerce clause analysis at all. [Citation.]" (*Barclay's supra*, 2 Cal.4th at p. 733.)

The *Barclay's* court summarized the evidence supporting its conclusion: "[O]ver the past 25 years, senior tax and foreign policy officials of the executive branch have sought to respond to the demands of foreign governments that the states be barred from applying formula apportionment to determine the tax liability of foreign-based multinationals. For much of this period, the chief forum for resulting executive branch initiatives was the Senate, where successive administrations sought to win ratification of a treaty provision barring state use of formula apportionment. But in 1978, with explicit recognition of the 'negative implications' of its act, the Senate *rejected* an income tax convention negotiated by the executive branch with the United Kingdom whose centerpiece was a provision—article 9(4)—prohibiting the states from using formula apportionment in determining the intrastate tax liability of United Kingdom-based multinationals. Only after the ban on state use of formula apportionment was stricken was the administration able to muster the two-thirds majority required for Senate ratification under the treaty clause.

"In addition, numerous bilateral tax treaties between the United States and other nations, although precluding use of formula apportionment by the signatory *national* governments, do not include within that prohibition political subdivisions such as the states. And while such tax treaties *do* include substantial governments within the scope of nondiscrimination provisions, they are *not* included within the prescription that the signatory governments employ an AL/SA [the arm's length/separate accounting alternative to the unitary business/formula apportionment] methodology in taxing local branches of foreign corporations. Similarly, so-called 'Friendship, Commerce and Navigation' treaties—a common form of commercial agreement between the

United States and its trading partners—typically require both the federal and state governments to tax foreign enterprises within their jurisdictions on a 'reasonably allocable or apportionable' basis, a standard which United States drafters viewed as 'intended to cover all the various methods, proportionate or otherwise, by which a reasonable tax base might be determined.' (U.S. State Dept., Standard Draft Treaty of Friendship, Commerce and Navigation, prepared by Charles H. Sullivan (Aug. 1980) pp. 202, 203.)

"Finally, in the wake of Senate rejection of article 9(4) and the decision in *Container* [*Corp. v. Franchise Tax Bd.* (1983)] 463 U.S. 159, upholding California's use of worldwide unitary methods in taxing domestic-parent multinationals, the executive branch scuttled its effort to achieve treaty-imposed curbs on the states' use of worldwide formula apportionment." (*Barclay's, supra*, 2 Cal.4th at pp. 733-734.)

The *Barclay's* court rejected the sort of material claimed by Alcancorp, and by amici curiae on its behalf, to evidence a "clear federal directive" sustaining its dormant foreign commerce clause case. "[R]ather than qualifying as a 'clear federal directive,' these materials, in the context of Congress's persistent refusal to regulate state taxation of multinationals and the Senate's explicit rejection of article 9(4) of the United States-United Kingdom treaty, embody nothing more than executive aspirations of what the federal government's policy in this area *ought* to be." (*Barclay's, supra*, 2 Cal.4th at p. 734, original italics.)

4. *Kraft Foods v. Iowa Dept. of Rev. (1992) 505 U.S. _____ [120 L.Ed.2d 59, 112 S.Ct. 2365] Is Inapposite*

In a supplemental letter brief, Alcancorp cites *Kraft Foods v. Iowa Dept. of Rev.* (1992) 505 U.S. _____ [120 L.Ed.2d 59, 112 S.Ct. 2365], as supportive of its position. In that case, Iowa taxed dividends received from foreign subsidiaries, but not dividends received from domestic subsidiaries, of Kraft General Foods, Inc., a unitary business with operations in the United States and several foreign countries. The United States Supreme Court held this disparate treatment violated the foreign commerce clause. *Kraft Foods* has nothing to do with the question whether the dormant foreign commerce clause precludes imposition by a state of a unitary tax based on the worldwide income of a multinational corporate taxpayer.

DISPOSITION

The judgment is affirmed.

NOT TO BE PUBLISHED

HINZ, *J.*

We concur:

KLEIN, *P. J.*

CROSKEY, *J.*

ORDER OF THE SUPREME COURT OF THE STATE OF CALIFORNIA DENYING PETITION FOR REVIEW

(Filed February 11, 1993)

Second Appellate District,
Division Three, No. B065648
S030387

IN THE SUPREME COURT OF THE
STATE OF CALIFORNIA

IN BANK

ALCAN ALUMINUM CORPORATION,
Appellant,

v.

FRANCHISE TAX BOARD OF THE
STATE OF CALIFORNIA,
Respondent.

Appellant's petition for review DENIED.

The request for an order directing publication of the opinion is denied.

LUCAS
Chief Justice

STATEMENT OF DECISION OF THE SUPERIOR COURT OF CALIFORNIA FOR THE COUNTY OF LOS ANGELES

(Dated September 30, 1991)

DEPT. 67

SUPERIOR COURT OF CALIFORNIA,
COUNTY OF LOS ANGELES

Date: September 30, 1991 Honorable Kurt J. Lewin Judge	L. Rivas, Deputy Clerk None, (E.R.M.)

(Parties and Counsel checked if present)

C 196 604
ALCAN ALUMINUM CORPORATION

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA

HANCOCK ROTHERT & BUNSHOFT
By: Robert V. Richter
Counsel For Plaintiff

OFFICE OF THE ATTY GENERAL
By: Philip C. Griffin
Counsel For Defendant

[PAGE ONE OF THREE PAGES]

NATURE OF PROCEEDINGS: TRIAL NJ (MISC-AO) TAX LAW INTERPRETATION

ON THIS MATTER, HAVING HERETOFORE BEEN SUBMITTED TO THIS COURT FOR RESOLUTION; THE COURT NOW RULES AS FOLLOWS:

STATEMENT OF DECISION

The constitutionality of California's use of Worldwide Combined Apportionment (WCA) for the determination of the income tax assessed to a California subsidiary of a foreign parent under the Commerce Clause is the issue presented in this action. (Due Process questions are not presented.)

In *Barclays Bank International v. Franchise Tax Board (1990) 225 Cal App 3d 1342*, the District Court of Appeal for the Third District has recently held that the use of WCA in such circumstances is unconstitutional under the so called "dormant" commerce clause analysis of *Japan Line Ltd. v. County of Los Angeles (1979) 441 U.S. 434*. A hearing has been granted by our Supreme Court in *Barclays* and it is currently pending there. Notwithstanding, the parties insist that this Court proceed with the same determination in this action on the theory that the facts to which the parties stipulated somehow present a case specific circumstance differentiating this action, thereby rendering the determination here free from application of the determination to be made by the Supreme Court in *Barclays*. This Court can find nothing in the stipulation of facts which would have that effect.

The Superior Court for Sacramento County has found the use of WCA constitutional for other tax years of plaintiff not at issue here, deciding that *Wardair Canada v. Florida Department of Revenue (1986) 447 US 1*, not *Japan Line* controls, and that there is no need to undertake the dormant commerce clause analysis at all. The Court's analysis was that having failed to preclude the states' use of WCA, Congress has, by clear negative implication, authorized its use by the states. This Court concurs in that decision.

[PAGE TWO OF THREE PAGES] In *Barclays Bank* the Court of Appeal's analysis of the application of *Wardair* focused on five factors urged by the State. The first three, and particularly the fourth, the Court concluded, were too general to glean any negative implication. The Court opined that ". . . trying to assign a specific reason to legislative inaction, we must enter the realm of pure speculation. It is difficult enough trying to ascertain the legislative intent when a statute has been enacted, but trying to find meaning in legislative silence is about as difficult as hearing sound in a vacuum." (*Barclays Bank v. FTB supra 1362.)* But the fifth factor, the United States Senate's failure to ratify the UK-US tax treaty until the offending preclusion of a state's use of WCA was excised left little doubt that Congress was not inclined to impose such restriction. To be sure the Court of Appeal dismissed the significance of the Senate's declination to ratify the treaty observing that "Again, the Board simply reads too much into too little. . . . The treaty with article 9(4) included [the WCA limitation] received a full Senate vote of only 49 to 32, falling 5 votes short of the two thirds majority needed for ratification. . . . In light of these Senate tallies, it is difficult to see a congressional policy permitting states to use WWCR." This Court perceives some significance. The treaty could not find approval until the WCA preclusion was eliminated. Nothing could be clearer. The constitutional requirement of Senate ratification, after all, enjoys equal dignity with the commerce clause itself. Thus, it is hardly relevant to observe that the Senate did not act unanimously. Also this fifth factor ought not to be evaluated standing alone; it sheds light on what in its absence might be accepted about the first four factors: that they are far too general to provide a clear negative implication etc. Taken together the five factors advanced in *Barclays Bank* demonstrate a legislative intent on the part of

Congress not to restrict the states' use of WCA. The same factors are urged here and the presence of the fifth presents an *a fortiori* case to *Wardair* itself.

Plaintiff argues vehemently that the use of WCA, by states has been continuously and vigorously opposed by the executive branch and our various trading partners for years. It seems odd then that Congress has remained smugly silent with no consciousness that its silence would [PAGE THREE OF THREE PAGES] be construed by courts in the manner described in *Wardair*. Can it be that every time the question comes up in any context Congress turns a deaf ear in contemplation that the state or federal courts across the nation will come up with a uniform and correct treatment of disputes regarding the use of WCA? This seems unlikely in the extreme, even if the issue were more thorny or controversial. In any event, state courts ought to be cautious and circumspect before they preempt Congress in matters of national policy.

Again, parenthetically, the facts presented here do not present any case specific circumstances that differentiate this action from *Barclays Bank* or the action in the Sacramento Superior Court, as far as the application of the dormant commerce clause constitutionality analysis versus the reasoning of *Wardair* is concerned, and the determination forthcoming in the Supreme Court will, in all likelihood, be dispositive in this action upon appellate review.

Until the determination in the Supreme Court is made, however, for the reasons set forth above and those set out in defendant's Trial Brief, JUDGMENT IS FOR DEFENDANT.

A COPY OF THIS MINUTE ORDER IS MAILED THIS DATE BY U.S. MAIL ON BOTH APPEARING COUNSEL.

EXCERPTS FROM STIPULATION OF FACTS

Exhibit XXI

[Filed in the Superior Court of the State of California, County of Los Angeles, No. C-196604]

* * *

REASON FOR SHUTDOWN

The Riverside sheet products operation has lost money in every year since 1972, averaging some $900,000 of loss before interest and tax per year during the last four years. (See Appendix 1)

The current Annual Plan predicts a loss of $1.3 million in 1976 and a further loss of $0.7 million next year (after interest but before tax). Sales and booking volumes are running about 10% under plan levels so a substantial additional loss, perhaps up to $0.2 million, can be anticipated. For purposes of this analysis, a continuing pre-tax loss at $1.0-1.5 million per annum is assumed.

Once the plant is shut down and the property and equipment sold, this loss could be eliminated except for Riverside's $150,000 allocated share of the Cleveland office's costs (assuming, conservatively, that the efforts of that office could not be profitably redeployed elsewhere). The estimated annual saving of shutting down Riverside would, therefore, be $850,000 to $1,350,000. Net of depreciation at $360,000 this means an annual cash saving (before tax) of $0.5-1 million.

As of 31 January 1976 the total Riverside operation has $4 million in working capital and another $4 million of net fixed assets for a total capital employed of $8

million (See Appendix 2). Based on an estimated writeoff of $3 million, $5 million can be released for use elsewhere, once the land and buildings are finally sold. Assuming that this $5 million of capital could be employed to earn 10-20% before tax, or $0.5-1 million per year, the Riverside operation would have to generate at least this much cash to justify continuing operations.

Comparing this required profit to the estimated cash loss the gap is then $1-2 million per annum, and this is the principal reason for the proposed shutdown.

ALTERNATIVES

Major Modernization of Riverside Facilities

With a few exceptions, the Riverside equipment is narrow and obsolete. Due to the growth pattern of the facility, the layout is inefficient and the "wide" casting and hot rolling line is too narrow even for double width siding. Any modernization program to increase width capabilities beyond 26" would have to embrace almost the entire plant and would probably cost as much as or more than starting on a green fields basis. The California market would not justify this sort of expenditure.

Move to a New Site

If a sheet mill were to be built from scratch, it is unlikely that California would be the best site due to excessive taxation, stiff pollution controls, and the lack of an adequate market in the area. In any case, the required expenditure would be massive and cannot be contemplated in the forseeable future.

Cold Roll and Coat Only

Various intermediate measures have been reviewed, including shutting down the casting operation only. Unfortunately, none of these make a significant difference partly because the loss of ability to recycle process scrap more or less offsets any overhead savings.

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JOINT REPORT BY INLAND REVENUE AND U.S. TREASURY

UNITARY TAX

REVIEW OF PROGRESS TOWARDS RESOLVING THE PROBLEMS

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December 1991

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LIST OF CONTENTS

CHAPTER 1: INTRODUCTION

CHAPTER 2: WORLDWIDE UNITARY TAX

2.1 Introduction

2.2-2.5 Methods of taxing multinational corporations

2.6 The effects of the worldwide combined reporting method of unitary taxation

2.7 Review conclusion

CHAPTER 3: MODIFICATIONS IN UNITARY TAX LAW

3.1 Introduction

3.2 Changes in Californian law in 1986

3.3 Changes in Californian law in 1988

3.4 Views expressed in 1989

3.5 Review conclusion

CHAPTER 4: THE POSSIBILITY OF FURTHER MODIFICATIONS IN CALIFORNIA'S UNITARY TAX LAW

4.1-4.4 Visit of UK officials to California in 1990

4.5-4.8 Options for reform in 1990

4.9 Meeting with tax officials

4.10-4.12 The future

4.13 Review conclusion

CHAPTER 5: LITIGATION

5.1 US Federal Government's powers

5.2 Container case

5.3-5.6 Barclays case

5.7 Alcan case

5.8 Review conclusion

CHAPTER 6: RECOMMENDATIONS TO THE UK AND US GOVERNMENTS

6.1 The litigation field

6.2-6.3 The political field

CHAPTER 7: SUMMARY OF CONCLUSIONS

APPENDIX: NOTES

CHAPTER 1: INTRODUCTION

1.1 On 22 March 1989 the Financial Secretary to the Treasury in the UK said that the UK Government believed that progress had been made in the two previous years in resolving the unitary tax issue but that problems remained, in particular the fee which companies had to pay (in California) in order not to be subject to worldwide unitary tax. The Government proposed to review the situation jointly with the US Treasury later in the year (1).

1.2. The aim of this review is to assess progress made in modifying the worldwide combined reporting method of unitary taxation and the need for and possibility of further changes which might be made towards meeting the concerns which have been widely expressed about the present Californian State tax laws as they apply to multinational corporations.

1.3. As part of the review a small party of senior United Kingdom Government representatives went to California (which is the only remaining US State with substantial problems for multinational corporations in this area) in April 1990. The prime purpose of the visit was not to lobby but to seek guidance on the situation in California and the possibilities for further changes in the relevant tax provision.

1.4. The UK Parliament has on a number of occasions expressed its hostility to unitary tax. A motion against the tax was signed by 276 Members (nearly half the Members) of the House of Commons (2) in conjunction with a debate on unitary tax which took place in December 1989. In reply, the Financial Secretary made it clear that it was not the intention of the Government to repeal Section 812 of the Income and Corporation Taxes

Act 1988 which provides a retaliatory power which can be triggered to deny the tax credit which would otherwise be payable to US companies in unitary states (3).

1.5. The US authorities have also on a number of occasions expressed opposition to the States' (particularly California's) use of the worldwide combined reporting method of unitary taxation. President Reagan wrote in November 1985 that the Federal Government supported legislation which would effect a requirement that multinationals be taxed by states only on income derived from the territory of the United States ("the water's edge requirement") (4). Consistent with that statement, the US Department of Justice filed *amicus curiae* briefs in the case of *Barclays Bank International Ltd v. Franchise Tax Board* detailing the US executive branch policy with respect to California's use of worldwide combined reporting, both in the lower court in September 1986 (5) and in the intermediate appellate court in September 1988 (6). Both briefs presented the argument that California's use of worldwide combined reporting was an unconstitutional interference with the US Federal Government's exclusive authority to conduct foreign affairs and regulate foreign commerce. The US Department of Treasury in August 1989 said that the issue of unitary taxation remained a serious concern to the Treasury Department and to the administration of President Bush (7). On 17 November 1990 the Department of Justice appeared before the Californian Court of Appeal to argue the position of the US administration.

CHAPTER 2: WORLDWIDE UNITARY TAX

2.1. The UK and US Governments, together with a number of Governments of other countries, have opposed the use, by the State of California, of worldwide unitary

tax as a means of assessing the Californian tax liability of multinational companies. This method of tax assessment in the circumstances in which it is applied is contrary to the principles underlying the UK/US tax treaty (and other US tax treaties); is contrary to accepted international practice; is extremely cumbersome and burdensome for multinational companies; can result in double taxation of income earned by multinationals outside the US; and effectively extends the reach of the Californian tax authorities beyond the borders of the US.

Methods of taxing multinational corporations

2.2. All tax jurisdictions in which multinationals operate are faced with the problem of determining the amount of income properly attributable to their jurisdiction. The internationally accepted method, which underlies UK and US tax treaties, is known as the separate accounting or arm's length method. This method applies the principle that each taxing authority should levy tax only on the income arising within the borders of its jurisdiction. To enable jurisdictions to assess corporation tax liability, multinational corporations operating within those jurisdictions are asked to provide separate accounts as if they were independent corporations operating at arm's length from other parts of their business.

2.3. The UK and the US, like other taxing jurisdictions, recognize that multinational companies can, in effect, transfer profits between different taxing jurisdictions, by manipulating the prices at which different constituent parts of their multinational business sell goods or services to each other. Like other taxing authorities, the UK and US deal with this by reserving the right, when assessing the extent of a corporation's earnings

attributable to their jurisdiction, to adjust for tax purposes any transfer prices that have been manipulated, so that they reflect the true market price that would be paid between two independent corporations. The UK/US tax treaties, and other tax treaties, specifically allow the contracting states to make such adjustments.

2.4. Unitary taxation is an alternative way of dealing with the same problem. Instead of taxing the income earned within its taxing jurisdiction, a tax authority using unitary tax assesses the overall income of the group, and then levies tax on a certain proportion of that income. That proportion might be calculated by reference to the company's sales, employment, or assets within one taxing jurisdiction.

2.5. The unitary method is used fairly widely by different states in the US in respect of income earned *within the US.* The method works reasonably well where each of the taxing authorities have broadly similar accounting rules and standards and where the tax regimes and formulae used are compatible. These conditions are moderately well satisfied in varying degrees in the different states within the US.

The effects of the worldwide combined reporting method of unitary taxation

2.6. California has chosen to use the same method in respect of worldwide income. In this context the necessary conditions for the successful use of the unitary method are clearly not fulfilled. Accounting standards in different taxing authorities throughout the world vary very considerably from those within the US. Equally importantly, no country (and certainly not the US

Federal Government) adopts such a method. In these circumstances, the use of worldwide unitary tax has the following defects:

a. a multinational company which has to provide accounts to each taxing authority in whose jurisdictions it operates, according to the accounting standards and tax regime of that authority, then has to recalculate its worldwide earnings according to the accounting standards and tax regime of California. Clearly this is a major and costly burden;

b. in practice, determining what constitutes a unitary multinational group in some cases involves highly questionable and arbitrary assumptions. A multinational company which comes to a different judgment from that of the Californian tax authorities could find itself forced to make the burdensome calculations described at a. above several times over;

c. there is no reason in principle why the proportion of a multinational corporation's earnings which are properly attributable to any one taxing authority should necessarily be the same as the proportion of its sales, employment or assets in that taxing authority. If California uses worldwide unitary and other countries use separate accounting/arm's length, a multinational corporation could well end up being taxed on more than 100% of its worldwide income; it could also be taxed on much less than 100% of its worldwide income. The risk of double taxation or double exemption is clearly very real;

d. a multinational company which had assets, sales and payroll in California, but which happened to make a loss in any one year, could find itself paying tax on non-existent (or even negative) income. Or, alternatively, a multinational corporation which improved its profitability in, say, Australia, by reducing costs in that country, would, under the unitary method, find itself paying more tax in California (which would levy tax on a proportion of any increase in profits) even although there had been no change in the income earned in California;

e. the narrow circumstances which may justify an internationally agreed formulary apportionment of income (for example, for 24-hour, global trading of a single book of securities) do not exist in the majority of cases to which California applies the worldwide combined reporting method of unitary tax.

Review conclusion

2.7. We believe that the worldwide combined reporting method of unitary taxation in the circumstances in which it is applied by California remains contrary to internationally agreed standards embodied in the arm's length principle and that the ultimate goal of the UK and US Governments should remain the elimination of the worldwide combined reporting method of unitary taxation.

CHAPTER 3: MODIFICATIONS IN UNITARY TAX LAW

3.1. Since July 1984 there has been action to reform unitary tax in a number of US States—Oregon, Florida, Massachusetts, Montana, Indiana, Utah, Colorado, New Hampshire, Idaho, North Dakota, California and most recently Alaska—although in some cases the application of unitary tax to foreign-owned corporations is limited and not completely eliminated.

3.2. In 1985 the British Parliament enacted legislation (8) giving the UK Government powers to deny tax credits to multinational corporations based in California, as a form of retaliation against the worldwide combined method of unitary taxation. In the following year the Californian Assembly amended Californian law, so as to enable a multinational corporation to "elect" to be taxed on a "water's edge" basis. The "water's edge" basis was broadly similar to the internationally accepted arm's length/separate accounting method. However, this election required payment of an election fee and the Californian tax authorities had the right to disallow such an election (without refunding the fee) in a number of instances, at their sole discretion. This modification in the Californian law that took place in 1986 persuaded the British Government not to bring into operation the retaliatory powers.

3.3. In 1988 some further modifications were made in California which reduced the election period and rendered the Californian tax authorities' decisions subject to some form of appeal. However, the fee remained in the law. In addition, many of the administrative requirements and potential penalties create conditions under which many multinational corporations say that they are unable to operate. The modifications made, although welcome, do

not, therefore, remove all the concerns about the worldwide combined reporting method of unitary taxation.

3.4. This view is shared by other major industrialised countries. In June 1989, all Member States of the European Community reaffirmed in a letter to the US Secretary of State that the present law in California was unsatisfactory. In reply, Treasury Deputy Secretary Robson confirmed that the US shared the European Community's concerns, and stated that further progress would have to be made in California before the US Government's concerns were met (7). In 1989, Canada, Japan, Australia and Switzerland also made clear their continued opposition to the worldwide combined reporting method of unitary taxation.

Review conclusion

3.5. While California (and some other states) have made some significant modifications in their law in response to international criticism, further progress is required before concerns on this issue can be put to rest. To alleviate the concerns of the interested governments, it would be necessary at least to ensure that the choice between the worldwide combined reporting method and the "water's edge" method of reporting should be unconditional and not subject to any fee, penalty, or subsequent override. In pursuing these goals the Governments of the US and the UK recognize that, under the US federal system, provided the method does not infringe upon a power reserved to the Federal Government or is not otherwise denied a State by the US Constitution, the Federal Government cannot dictate precisely how a State determines income subject to its tax jurisdiction.

CHAPTER 4: THE POSSIBILITY OF FURTHER MODIFICATIONS IN CALIFORNIA'S UNITARY TAX LAW

4.1. Senior UK Government representatives went to Sacramento on 23-27 April 1990 following letters from the UK Chancellor of the Exchequer to US Treasury Secretary Brady and Governor Deukmejian and from Secretary Brady to Governor Deukmejian.

4.2. The purpose of the visit was to enable the UK to contribute to this UK/US review of progress on the unitary tax problem, in particular to assess what further modifications in unitary tax law could realistically be expected from the Californian legislature.

4.3. The delegation was grateful to Governor Deukmejian for setting aside time for a substantial meeting with him. The delegation was also grateful to key Senators and Assemblymen from both the Republican and Democratic parties, Senate/Assembly staffers, Californian tax officials and representatives of both Californian and British business who also made time to see them.

4.4. The administration made it clear that it had done much to meet UK concerns in introducing the modifications it had in 1986 and 1988. The Californian legislature had not been prepared to eliminate the worldwide combined reporting method of taxation completely but had provided for an alternative. Some 700 businesses (out of possibly 5000) had elected for water's edge, of which about 50 were UK companies.

Options for reform in 1990

4.5. There seemed to be two possibilities for legislative changes in 1990.

4.6. *First*, a revenue neutral Bill which failed earlier in the year (proposed by Assemblyman *Brown*) was re-introduced, this time by Assemblyman *Peace* (9). This would have reduced the election period (not to be subject to the worldwide combined reporting method of unitary taxation) from 5 years to 3 years and abolished, with treble damages for wilful default, the provision under which companies can be thrown back on unitary tax (the 'throwback') and the domestic spreadsheet. It did not deal with the election fee (see paragraph 4.7 below).

4.7. The *second* possibility for legislation in 1990 was that abolition of the election fee might feature in a Tax Conformity Bill. It was, however, urged on the UK Government delegation by Senators and Assemblymen that the Californian budget currently faced a $2 billion deficit (although the election fee—some $40 million—was small in this context).

4.8. In the event neither legislative possibility materialised and there was virtually no progress on the legislation front in 1990. The only Bill that did pass (*Alquist*) provided mainly for election fees to be refunded with interest if the Courts finally ruled the worldwide combined reporting method of unitary taxation unconstitutional (10).

Meeting with tax officials

4.9. One point that came out of a very detailed meeting the UK delegation had with Californian tax officials was that the latter confirmed that the throwback provision (see paragraph 4.6 above) would be used only in the most extreme circumstances of wilful default. Although it would of course be preferable to have the throwback abolished altogether, this confirmation was helpful and letters were exchanged to this effect.

The future

4.10. The end of the 1988-1990 two year session of the Californian legislature has now passed and there can be no assurance of any immediate modifications to unitary tax law.

4.11. It is understood that the Auditor General is required to make a review of the spreadsheet and make a preliminary report to the Legislature by 31 December 1991.

4.12. The Californian Franchise Tax Board said that when a Bill was introduced in 1989 to repeal the election fee an analysis indicated that this would cost annually something like $100 million. This loss was made up of two components. First, there was the loss of the fee itself which would have had a $35 million impact. Second, under the Board's assumptions, more people would elect if the fee were eliminated giving rise to a $60-$65 million revenue loss. These estimates were mid-year 1989 and economic circumstances had changed which would, in all likelihood, result in a change in the estimates.

Review conclusion

4.13. It is disappointing that no substantial progress was made on legislation in 1990 and that there can be no assurance of any immediate prospect of legislation. However, the undertaking of the Franchise Tax Board on throwback was helpful.

CHAPTER 5: LITIGATION

5.1. Under the US Constitution the power to conduct foreign affairs and to regulate commerce with foreign nations is reserved to the Federal Government. Where

state or local taxes result in actual international multiple taxation, where such a tax "may impair federal uniformity in an area where federal uniformity is essential", and where such a tax prevents "the Federal Government from 'speaking with one voice' when regulating commercial relations with foreign governments", the tax can be held to be unconstitutional by US courts and may not be collected. See *Japan Line Ltd v County of Los Angeles*, 441 US 434 (1979).

5.2. Early efforts to challenge the constitutionality of the Californian worldwide combined reporting method of unitary taxation under this principle were brought by US-based parent corporations with foreign subsidiaries. They did not succeed. See *Container Corporation of America v Franchise Tax Board*, 463 US 159 (1983). The US Supreme Court, however, in a footnote to its decision in *Container*, explicitly stated that it was not addressing the constitutionality of the worldwide combined reporting method with respect to state taxation of US corporations with foreign parents or of foreign corporations. More recently *Colgate-Palmolive Company Inc*, a US-based parent corporation with foreign subsidiaries, has again challenged the constitutionality of Californian worldwide reporting in the Californian Courts. A decision favourable to Colgate in the Californian Superior Court for the County of Sacramento was reversed in August 1991 by the Californian Court of Appeal which could not find a meaningful distinction between that case and the earlier *Container* decision. The company has since filed a Petition for Hearing in the Californian Supreme Court.

5.3. Cases have been brought by foreign corporations and the US subsidiaries of foreign corporations to address the question left open in the *Container* case. In

Barclays Bank International Ltd v Franchise Tax Board, 275 Cal.Rptr.626 (1990), the Court of Appeal of the State of California on 27 December 1990 affirmed the judgment of the Superior Court of California for the County of Sacramento that the worldwide combined reporting method was unconstitutional under the US Constitution's commerce clause. An appeal against that decision has been made by the Franchise Tax Board to the Californian Supreme Court, which has announced that it will hear the appeal. Either party may appeal against its decision to the United States Supreme Court.

5.4. Unlike in the *Container* case, the US Department of Justice filed an *amicus curiae* brief in *Barclays* both before the trial court as well as in the Californian Court of Appeal. The *amicus* briefs presented the argument that California's use of the worldwide combined reporting method is an unconstitutional interference with the US Federal Government's exclusive authority to conduct foreign affairs and regulate foreign commerce. The Californian Appellate Court in its decision in *Barclays* noted that the filing of the *amicus* brief, the US/UK income tax treaty debate, a letter from President Carter's administration to the State of California, and President Reagan's directive to the Attorney General all demonstrated that the US Federal Government had spoken clearly in opposition to the worldwide combined reporting method. The Appellate Court also found that "every single nation in the industrialised western world has sent letters to the United States Government protesting the use of worldwide combined reporting by American states", and took note of the UK's enactment of retaliatory legislation and the cancellation of several trade missions to the United States. The Court also took note of evidence presented to it by Barclays regarding its incurring a one-time cost of between $6.4 million and

$7.7 milion to establish a system of reporting to comply with the requirements of California's worldwide combined reporting and an additional expense from $2 to $3.8 million each year to maintain the system. The Appeals Court decision in *Barclays* was unanimous.

5.5. The Californian Supreme Court has agreed to hear the appeal against the judgment of the Californian Court of Appeal, and the US Government has prepared an *amicus* brief and sought the Court's permission to file it.

5.6. A preliminary injunction was issued in October 1989, in two suits against the Californian Franchise Tax Board, ordering that about $9.5 million in election fees paid to California (fees paid to elect for the use of the water's edge reporting method) be placed into escrow pending the outcome of constitutionality challenges. See *Nestle Holding Inc v FTB,* California Superior Court, San Francisco County, No.911305 and *Coca Cola Company v. FTB,* California Superior Court, San Francisco County, No.911416.

5.7. In recent Court decisions involving *Alcan Aluminium Corp.* it was held that California's use of the worldwide combined reporting method of unitary taxation was constitutional. However, these cases will be proceeding to appeal.

Review Conclusion

5.8. The recent decision (on 27 December 1990) of the Californian Court of Appeal in the *Barclays* case confirms that a satisfactory solution to the problems faced by UK-based multinationals doing business through subsidiaries in California stands a good chance of being reached by litigation in the US courts, particularly where the US Federal Government makes its views known through the filing of *amicus* briefs.

CHAPTER 6: RECOMMENDATIONS TO THE UK AND US GOVERNMENTS

6.1. Following the recent welcome confirmation in the Californian Appeal Court that the worldwide combined reporting method of unitary taxation, as applied to foreign-based unitary groups, is unconstitutional, *we recommend* that both Governments should continue strongly to support litigation against worldwide unitary tax.

6.2. UK Government statements up to 22 March 1989 (1) have made clear that, in the event of the retaliatory legislation being activated, it would not apply to dividends paid on or before 31 December 1989.

6.3. Pending a settlement of the matter by litigation, *the UK reviewers recommend* that the *United Kingdom* should maintain its retaliatory legislation on the statute book, giving no further guarantees as to whether the legislation, if it were to be triggered, would be retrospective, but should not trigger it; *the US reviewers recommend* that the *United States* should defer taking any action on the declaration of President Reagan in 1985 and subsequent statements by the federal authorities, except as recommended in 6.1., above but that the situation shall be reassessed should the position of the US administration not be upheld in Court.

CHAPTER 7: SUMMARY OF CONCLUSIONS

7.1. The reviewers conclude that

a. the worldwide combined reporting method of unitary taxation remains contrary to internationally agreed standards embodied in the arm's length principle (paragraph 2.7);

b. the ultimate goal of the UK and US Governments should remain the elimination of the worldwide combined reporting method of unitary taxation (paragraph 2.7);

c. while California has made some relaxations in its law in response to international criticism, further progress is required before concerns on this issue can be put to rest. Californian tax law should at least ensure a meaningful choice—unconditional and not subject to any fee, penalty or subsequent override—between the worldwide combined method of reporting and the water's edge method (paragraph 3.5);

d. it is disappointing that no substantial progress was made on legislation in 1990 and there can be no assurance of any immediate prospect of legislation (paragraph 4.13);

e. the recent decision in the Californian Appeal Court (on 27 December 1990 in the Barclays case) that the worldwide combined reporting method of unitary taxation, as applied to foreign-based unitary groups, is unconstitutional confirms that a satisfactory solution stands a good chance of being reached by litigation in the US courts (paragraph 5.8); and

f. both Governments should continue strongly to support litigation against worldwide unitary tax (paragraph 6.1);

7.2. Pending a settlement of the matter by litigation,

a. *the UK reviewers* conclude that *the UK* should maintain its retaliatory legislation on the statute book, giving no further guarantees as to

whether the legislation, if it were to be triggered, would be retrospective, but should not trigger it (paragraph 6.3);

b. *The US reviewers* conclude that *the US* should not take any further action on the declaration of President Reagan in 1985 and subsequent statements by the federal authorities, except as stated in paragraph 7.1.f. above but that the situation shall be reassessed should the position of the US administration not be upheld in Court (paragraph 6.3).

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APPENDIX: NOTES

1. HM Treasury Press Release of 22 March 1989.
2. UK Parliamentary motion of 15 December 1989.
3. Hansard 18 December 1989 Cols 172-178.
4. HM Treasury Press Release of 8 November 1985.
5. Superior Court of the State of California, County of Sacramento, Nos 325059 and 325061.
6. Court of Appeal of the State of California, Third Appellate District 3 Civil C003388 (Consolidated with C003389).
7. US Treasury statement of September 1989.
8. Section 812 Income and Corporation Taxes Act 1988.
9. California Legislature—1989-90 Regular Session—Assembly Bill No. 3333.
10. Senate Bill No 2177.